

FILE COPY

No. **139** 56

Office - Supreme Court, U. S.
FILED
APR 9 1945
CHARLES ELMORE CROPLEY CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1944

KIRBY PETROLEUM COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FIFTH CIRCUIT AND
SUPPORTING BRIEF

HOMER L. BRUCE,
Attorney for Petitioner.

INDEX

SUBJECT INDEX

	PAGE
Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit	1-7
Summary Statement of the Matter Involved	1-3
Jurisdiction	4
Questions Presented	3
Reasons Relied on for the Allowance of the Writ	5-7
Brief in Support of Petition for Writ of Certiorari	9-25
Opinions Below	9
Jurisdiction	9
Statement of the Case	10
The Law	10-11
Specification of Errors	11-12
Summary of the Argument	12-25
A. The Circuit Court of Appeals had no authority to make findings of fact and inferences of fact contrary to those of the Tax Court and thereby hold petitioner was not entitled to the depletion claimed.	12-15
B. Petitioner at all times had an economic interest in the oil and gas produced and was entitled to the depletion allowance of 27½% of the amount received by it under the 20% of net profits provision.	12, 15-25
Conclusion	25

TABLE OF CASES CITED

	PAGE
Anderson v. Helvering, 310 U. S. 404	6, 17, 21
Burnet v. Harmel, 287 U. S. 103	6, 18
Choate v. Commissioner, 65 S. Ct. 469	5
Commissioner v. Felix Oil Company, 144 F.2d 276	5, 6, 15
Dobson v. Commissioner, 320 U. S. 489	5, 14
Green v. Commissioner, 26 B. T. A. 1017	14
Helvering v. Bankline Oil Company, 303 U. S. 362	6, 19
Helvering v. Elbe Oil Land Development Company, 303 U. S. 372	6, 17, 20
Helvering v. O'Donnell, 303 U. S. 370	6, 17, 20
Murphy Oil Company v. Burnet, 287 U. S. 299	6, 18
Palmer v. Bender, 287 U. S. 551	6, 18
Spalding v. U. S., 97 F.2d 697	22
Wilmington Trust Company, Executor, v. Helvering, 316 U. S. 164	5, 14

OTHER AUTHORITIES CITED

	PAGE
Internal Revenue Code:	
Section 23	10
Section 114	11

No.....

IN THE
Supreme Court of the United States
OCTOBER TERM, 1944

KIRBY PETROLEUM COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FIFTH CIRCUIT

May it Please the Court:

Petitioner, Kirby Petroleum Company, respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Circuit Court of Appeals in reversing the judgment of the Tax Court of the United States. Petitioner respectfully shows to this Honorable Court:

1.

Summary Statement of the Matter Involved.

This case was tried before the Tax Court on the

pleadings (R. 4-15) and stipulation (R. 32-34).

Petitioner owned the *fee title* to a tract of land except that there was outstanding a $1/8$ interest in the minerals. On September 29, 1927, it executed a regular oil and gas mineral lease (R. 35-41) upon the property, reserving a royalty of $1/6$ on oil and in substance $1/6$ on the amount realized from the sale of gas. Out of its $1/6$ royalty it absorbed the outstanding $1/8$ interest so that its gross royalty was a net $1/24$ (R. 6, par. (A) (6)). On the same day it executed an agreement (R. 42-50) with the lessees, which recited the execution of the lease and provided that the lessees should also pay petitioner 20% of the net profits derived by the lessees from their operations under the lease and then provided in detail for the accounting procedure in the determination of the net profits. Both the lease and the agreement were executed by George Sawtelle, a Vice-President of petitioner. It was stipulated (R. 33) that he, if sworn, would testify that petitioner would not have executed the lease unless the lessees had also executed the contemporaneous agreement as a part of the consideration for petitioner's executing the lease, and that the lessees did execute the agreement as part of the consideration for petitioner's executing the lease, and that the petitioner also received upon the execution of the lease a cash bonus from the lessees for executing the lease. This testimony was uncontradicted.

Production was obtained in 1932 and in 1935 petitioner received its first payment under its net profits agreement, and received such payments of profits for

each year through 1940, the year involved. For 1940 its part of the net profits was \$26,223.70 and in its income tax return for that year it deducted as depletion $27\frac{1}{2}\%$ of this amount. The Commissioner disallowed this depletion deduction (R. 33). The Commissioner did not question its deduction for depletion on its $\frac{1}{24}$ royalty.

Petitioner appealed to the Tax Court on this one point. The Tax Court in its opinion and decision (R. 16-23) held that petitioner was entitled to the depletion allowance, and held that in granting the lease the petitioner retained for itself the $\frac{1}{6}$ oil royalty and 20% net profits from the operation of the lease each year. The Circuit Court of Appeals reversed the judgment of the Tax Court and apparently held that, although petitioner to the extent of the cash bonus and the $\frac{1}{6}$ royalty retained an economic interest in the oil and gas in place, it nevertheless surrendered all of its other interest and retained no economic interest in the oil and gas in place by virtue of which it received 20% of the net profits and received this merely as a result of its having a chose in action or economic advantage (R. 54).

Circuit Judge Hutcheson filed a dissenting opinion, holding that the Tax Court should be affirmed and that petitioner was entitled to the depletion allowance on the net profits to the same extent as it was on the $\frac{1}{6}$ royalty.

**Statement Disclosing Basis Upon Which It Is Contended
This Court Has Jurisdiction.**

The jurisdiction of this cause is conferred upon this Honorable Court by Judicial Code, Section 240, as amended; United States Code, Title 28, Section 347.

The judgment of the Circuit Court of Appeals was entered March 5, 1945 (R. 66.)

Questions Presented.

1. When the Tax Court had found that the execution of the lease and contract was in substance all one transaction, that the petitioner in granting the lease retained for itself a royalty equivalent to 1/6 of the gross and 20% of the net profits, and that petitioner had an economic interest in the oil in place and was entitled to depletion on the 20% net profits received, was the Circuit Court of Appeals authorized to disregard these findings of fact and find the transactions were separate, that the 20% did not represent any retained royalty, that petitioner did not retain any economic interest and that petitioner was not entitled to depletion on the 20% net profits receipts?

2. Was the petitioner entitled to depletion on the amount received by it under the 20% net profits provision?

Reasons Relied on for the Allowance of the Writ.

The reasons relied on for the allowance of the writ are that the Circuit Court of Appeals has decided important questions of Federal law which have not been and should be settled by this Court, that these questions have been decided in a way probably in conflict with the applicable decisions of this Court, and that they have been decided in a way directly in conflict with the decision of the Ninth Circuit Court of Appeals in *Commissioner of Internal Revenue v. Felix Oil Company*, 144 F.2d 276.

(1) The Tax Court held that the execution of the lease reserving a $\frac{1}{6}$ royalty and of the contract providing for 20% of the net profits was one transaction, that petitioner in granting the lease reserved both the $\frac{1}{6}$ royalty and the 20% of the net profits, that petitioner retained an economic interest in the oil represented by the 20% net profits, and that petitioner's "gross income from the property" within the meaning of Section 114 (b) (3) of the Internal Revenue Code was the proceeds of both the $\frac{1}{6}$ royalty and of the 20% net profits, and therefore it was entitled to depletion on the net profits proceeds. The Circuit Court of Appeals disregarded these findings of fact and the inferences of fact drawn by the Tax Court and substituted its own contrary to the proper rule laid down by this Honorable Court in *Wilmington Trust Company, Executor v. Helvering*, 316 U. S. 164; *Dobson v. Commissioner*, 320 U. S.

489, and *Choate v. Commissioner*, 65 S. Ct. 469, (decided January 29, 1945).

(2) The Circuit Court of Appeals in denying petitioner depletion on the proceeds of its 20% of the net profits is in direct conflict with the holding of the Ninth Circuit Court of Appeals in *Commissioner of Internal Revenue v. Felix Oil Company*, 144 F.2d 276. In the latter case the landowner executed a lease and the only royalty reserved was 50% of the net profits and the Ninth Circuit Court of Appeals held the landowner was entitled to depletion on the proceeds of the 50% of the net profits. The holding of the Circuit Court of Appeals is also contrary to the fundamental holdings of this Court on matters of depletion in *Burnet v. Harmel*, 287 U. S. 103; *Murphy Oil Company v. Burnet*, 287 U. S. 299, and *Palmer v. Bender*, 287 U. S. 551, and its actual decisions in the so-called net profits cases of *Helvering v. O'Donnell*, 303 U. S. 370, and *Helvering v. Elbe Oil Land Development Company*, 303 U. S. 372, and in the cases of *Helvering v. Bankline Oil Company*, 303 U. S. 362, and *Anderson v. Helvering*, 310 U. S. 404.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit commanding said court to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the record of all of the proceedings in the Circuit Court of Appeals in said cause entitled *Commissioner of*

Internal Revenue, Petitioner, v. Kirby Petroleum Company, Respondent, No. 11065 on its docket, to the end that said cause may be reviewed and determined by this Court as provided by Section 240 of the Judicial Code, as amended, and that your petitioner may have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity with the provisions of the Judicial Code, and that on hearing before this Honorable Court said judgment of the Circuit Court of Appeals be reversed.

KIRBY PETROLEUM COMPANY,

By HOMER L. BRUCE,
Attorney for Petitioner.

No.....

IN THE
Supreme Court of the United States
OCTOBER TERM, 1944

KIRBY PETROLEUM COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR
WRIT OF CERTIORARI

I.

The Opinions of the Courts Below.

The opinion of the Tax Court is found at page 16 of the record and is reported in 2 T. C. 150. The opinion of the Circuit Court of Appeals has not been reported but is found at page 54 of the record.

II.

Jurisdiction.

Stated under heading 2 of the petition.

III.

Statement of the Case.

A full statement of the case has been given under heading 3 of the petition and in the interest of brevity is not repeated.

IV.

The Law.

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion*.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b)—*Basis for Depletion.*—

* * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells, the allowance for depletion under Section 23 (m) shall be $27\frac{1}{2}$ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under Section 23 (m) be less than it would be if computed without reference to this paragraph.

* * * * *

(26 U. S. C. 1940 ed., Sec. 114.)

V.

Specification of Errors.

1. The Circuit Court of Appeals erred in substituting its findings of fact and inferences of fact contrary to those of the Tax Court and in thereby holding that petitioner was not entitled to depletion on the proceeds of the 20% net profits.
2. The Circuit Court of Appeals erred in holding that petitioner was not entitled to the depletion allowance on the amount received by it under the pro-

vision of its contract that it was to receive 20% of the net profits from the operation of the properties.

ARGUMENT.

Summary of the Argument.

Point A.

The Circuit Court of Appeals had no authority to make findings of fact and inferences of fact contrary to those of the Tax Court and thereby hold petitioner was not entitled to the depletion claimed.

Point B.

Petitioner at all times had an economic interest in the oil and gas produced and was entitled to the depletion allowance on the amount received by it under the 20% of net profits provision.

Point A.

The Tax Court in its opinion, after setting out the facts, summarized the contentions and distinctions made by petitioner (R. 19-20) and concluded in that part of its opinion as follows (R. 20):

"In the instant case petitioner lays emphasis on the fact that it was the owner in fee simple of two tracts of land and leased them to Humble and to Marland for development and operation and that in granting the lease it retained for itself a $\frac{1}{6}$ oil royalty and 20 percent net profits from the operation of the lease each year. Respondent has not disputed petitioner's right to percentage depletion on the $\frac{1}{6}$ oil royalty reserved in the lease but does dispute petitioner's

right to percentage depletion on the \$26,223.70 net profits which petitioner received in 1940 from operations.

"Petitioner contends that it is as much entitled to depletion on this \$26,223.70 as it is on the receipts from its 1/6 oil royalty and distinguishes its situation from that which existed in *Helvering v. O'Donnell, supra*, and *Helvering v. Elbe Oil Land Developing Co., supra*, and *Anderson v. Helvering, supra*, on the grounds which we have already stated. We agree with petitioner in the distinction which it draws."

In discussing what was the gross income under Section 114 (b) (3) of the Internal Revenue Code, the Tax Court said (R. 21):

"What is petitioner's 'gross' income from the property' in 1940 within the meaning of Section 114 (b) (3) and which it must include in its gross income for income tax purposes? We think it is clearly the proceeds from the 1/6 royalty which petitioner retained in the lease and the 20 percent annual profits which it received from the operation of the lease under the contemporaneous agreement amounting in 1940 to \$26,223.70. If this view is correct, then petitioner is entitled to percentage depletion on the amounts received from its part of the profits as much as from the amounts received from its retained 1/6 oil royalty."

Judge Hutcheson in his dissenting opinion agreed with this analysis by the Tax Court, but the majority of the Court held that the lease and contract were entirely different transactions, that the peti-

tioner reserved an economic interest represented by its 1/6 royalty but had no economic interest represented by the 20% of net profits, and for that 20% "accepted the personal covenant of the lessees to pay whatever amount of the net profits became due by the lessees."

This Court in *Dobson v. Commissioner*, 320 U. S. 489, held that a determination of the Tax Court as to whether particular transactions are integrated or separated for tax purposes is no more reviewable than any other question of fact. Here the Tax Court held that the lease and contract were for tax purposes all one transaction and agreed with petitioner's contention "that in granting the lease it (petitioner) retained for itself a 1/6th oil royalty and 20 per cent net profits from the operation of the lease each year" and that petitioner's gross income for depletion purposes was the 1/6th royalty and the 20% profits. These findings and the other findings were binding upon the Circuit Court of Appeals under the decisions of this Court in *Dobson v. Commissioner, supra*; *Wilmington Trust Company v. Helvering*, 316 U. S. 164, and *Choate v. Commissioner of Internal Revenue*, 65 S. Ct. 469, decided January 29, 1945. Such a rule is particularly salutary in a case like this in the interest of uniformity in applying the tax law. We refer particularly to the discussion on this in the footnote at page 499-500 of 320 U. S. in this Court's opinion in *Dobson v. Commissioner*. As far back as 1932 the Board of Tax Appeals held' that where a landowner

¹*Green v. Commissioner*, 26 B. T. A. 1017.

leased his land and obtained a royalty of a certain percent of the net profits, he was entitled to depletion thereon. The Commissioner acquiesced in that case in 1933² and did not contend to the contrary until 1942 in the *Felix Oil Company* case³. Both the Board of Tax Appeals and the Ninth Circuit held again that the landowner was entitled to depletion on the net profits reservation. The Tax Court in the present case made the same findings and for the sake of uniformity in the administration of the taxing statutes, the Circuit Court of Appeals under the authorities of this Court above referred to should not have substituted its own findings and inferences of fact for those of the Tax Court.

Point B.

The decision of the Circuit Court of Appeals in this case is in direct conflict with the holding of the Ninth Circuit Court of Appeals in the *Felix Oil Company* case⁴. In that case the Company owned certain acreage in fee and executed an oil and gas lease on it, but, instead of retaining a gross royalty, it retained only the right to receive 50% of the net profits. The Commissioner argued there, as here, that the Oil Company had sold the property and was entitled to no depletion. The court pointed out that the agreement

²XII-1 C. B. 6.

³Memorandum Decision by the Tax Court of December 18, 1942, not published in the regular reports but found as C. C. H. Decision 12,920-A of: Commerce Clearing House, Inc.: Tax Court Service, and affirmed by the Ninth Circuit Court of Appeals in 144 F. 2d 276 from which the Commissioner took no appeal.

⁴*Commissioner v. Felix Oil Company*, 144 F. 2d 276.

was like an ordinary oil and gas lease, with rights of forfeiture in the landowner for failure to develop, etc. The court then said, in rejecting the Commissioner's contention:

"We see no reason for rejecting this interpretation of the contract. It is clear that the taxpayer retained an economic interest in the oil in place. It had a capital investment in the land and in the paying wells, and the income it received from production was not, we think, income arising from a sale of the oil before severance. Cf. *Palmer v. Bender*, 287 U. S. 551, 53 S. Ct. 225, 77 L. Ed. 489; *Helvering v. Elbe Oil Land Development Co.*, supra; *Helvering v. Mountain Producers Corporation*, 303 U. S. 376, 58 S. Ct. 623, 82 L. Ed. 907. In the case last cited the Supreme Court said (303 U. S. at page 382, 58 S. Ct. at page 625, 82 L. Ed. 907) that 'the term "gross income from the property" means gross income from the oil and gas * * * and the term should be taken in its natural sense. With the motives which lead the taxpayer to be satisfied with the proceeds he receives we are not concerned'."

This Honorable Court should grant a writ of certiorari in this case, if for no other reason, so that this conflict between the Ninth and Fifth Circuits may be resolved.

As to the merits of the case, we respectfully refer to the dissenting opinion of Judge Hutcheson in this case as it succinctly sets forth the views of petitioner.

The purpose of the depletion allowance is to allow an owner of an interest in the minerals to recover

his cost thereof through his income from the minerals. In the case of *Felix Oil Company* the landowner could never recover any part of his costs of the minerals unless it were allowed depletion as all it reserved was an interest in the net profits, but it was entitled to those net profits because of its ownership in the minerals. In this case petitioner leased the land for a fractional royalty measured by gross production and a fractional royalty measured by net profits. It was all one income to petitioner which it obtained because it owned the minerals and was willing to execute a lease on these terms. In view of the record and of the findings of the Tax Court the lease and contract were all one transaction and are to be treated as if they were one instrument reserving a royalty of $1/6$ of the gross and 20% of the net profits. We refer to the analysis of the contract set forth in footnote 4 of Judge Hutcheson's opinion, where he shows that under clause IV of the contract the lessor and lessee were both interested in all oil to be marketed from the premises and that this was not a mere personal obligation on the part of the first lessees but was a contract that was binding upon their successors in interest in the lease.

The opinion of the Circuit Court of Appeals says that the present case cannot be distinguished from the *O'Donnell*, *Anderson* and *Elbe Oil Company* cases⁵. We will refer to them later in this brief.

This Court in every case has held that, where a party owned an economic interest in the oil and gas

⁵*Helvering v. O'Donnell*, 303 U. S. 370; *Anderson v. Helvering*, 310 U. S. 404; *Helvering v. Elbe Oil Land Development Company*, 303 U. S. 372.

as distinguished from merely an economic advantage through a contract, he was entitled to the depletion allowance through which to recover his capital investment, and the test laid down by this Court is whether such a party does have an economic interest in the minerals.

In two of the earlier cases⁶, this Court held that a landowner upon executing a lease was entitled to depletion upon both the bonus and the royalties as a source from which to recover his capital investment in the minerals.

• In the next case⁷ this Court had before it the question of whether a lessee, who upon assigning a lease received a cash bonus and retained an oil payment and an overriding royalty, was entitled to depletion on these items. This Court first referred to the nature of the lessor's right to depletion, saying on page 557:

“Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough if, by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so he has an economic interest in the oil, in place, which is depleted by production. Thus, we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the minerals, in place, passed from the lessor upon the execution of the lease. See *Burnet v.*

⁶*Burnet v. Harmel*, 287 U. S. 103; *Murphy Oil Company v. Burnet*, 287 U. S. 299.

⁷*Palmer v. Bender*, 287 U. S. 551.

Harmel, *supra*; Bankers Pocahontas Coal Co. v. Burnet, ante, p. 308."

It then referred to the specific case before it and, in holding the lessee-assignor entitled to depletion, said on page 558:

"Thus, throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partnerships and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time from the date of the leases until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case."

The *Bankline Oil Company case*⁶ is not even comparable to the present one. The taxpayer operated a casinghead gasoline plant for the extraction of gasoline from wet gas, and the only connection that it had with any production was that it had two types of contracts with producers of gas, under one of which the gas was delivered to the taxpayer who extracted the gasoline and agreed to pay the producer 1/3 of

⁶*Helvering v. Bankline Oil Company*, 303 U. S. 362.

the gross proceeds from the sale of the gasoline or to deliver to him $1/3$ of the gasoline, and under the other the taxpayer purchased outright from the producer all the natural gas and agreed to pay the producer $1/3$ of the gross proceeds received from the sale of the extracted gasoline. There the taxpayer never had any remote interest in the minerals in place.

The *O'Donnell* case⁹ was the first so-called net profits case decided by this Court. The taxpayer there never had any interest at any time in the oil and gas. He merely owned part of the stock of the San Gabriel Petroleum Company, which he sold to Petroleum Midway Company, Ltd., and, as consideration for the payment for the stock, the Midway Company agreed to acquire the properties of the San Gabriel Company and pay the taxpayer $1/3$ of the net profits from the operation of those properties. That is a far cry from the present case where petitioner was the landowner and in substance made a lease retaining a royalty measured by the gross production and another royalty measured by the net profits.

In the next so-called net profits case¹⁰, which the lower court says cannot be distinguished from the present case, taxpayer did own an interest in certain oil and gas properties, but it made an absolute sale of all of its interest in those properties for \$350,000 cash, \$1,650,000 additional cash payable over a period of four years, and for the additional agreement by the

⁹*Helvering v. O'Donnell*, 303 U. S. 370.

¹⁰*Helvering v. Elbe Oil Land Development Company*, 303 U. S. 372.

purchaser to pay taxpayer 1/3 of the net profits resulting from the operation of the properties after the purchaser had recovered all its expenditures in the acquisition, development and operation of the properties. As pointed out by this Court on page 374, the agreement specifically provided that: . .

"It is the intention of the parties to this agreement that the full ownership, possession and control of all the properties * * * shall be vested in Honolulu (purchaser) and Elbe shall have no interest in or to said properties * * * ."

This Court simply held that, after the execution of such contract, the taxpayer had no further interest in the properties and received its net profits as part of the consideration for a sale of its interest.

In the third case that the lower court says cannot be distinguished" the owner of certain royalty interests, fee interests and deferred oil payments, sold the same to a purchaser for \$50,000 cash and \$110,000 to be paid from one-half the proceeds received by the purchaser from oil and gas produced from the properties and from the sale of the lands owned in fee, the lesser retaining a lien upon all of the properties. The question involved was whether the purchaser should be required to include in his income the entire proceeds received from the oil and gas produced although one-half was paid to the seller. This Court held that this was a completed sale of the properties, that the purchaser obtained the entire interest and that the payments to the seller were merely by way

¹¹Anderson v. Helvering, 310 U. S. 404.

of purchase price. We cannot see the applicability of that case to the present one.

One last case¹² will be referred to. Taxpayer owned certain leases and made a contract with an oil company under which the oil company was granted the right to go upon the leased properties, drill wells thereon and produce all the oil and gas therefrom at its own expense. The contract then provided that all the oil and gas should be delivered to the taxpayer, who would sell the same and pay the oil company two-thirds of the net proceeds, with the provision that if the lessor took its royalty of 5% in oil, the taxpayer would pay the oil company $61 \frac{2}{3}\%$ of the net proceeds. In that case the taxpayer was actually obtaining one-third of the net proceeds from the operation of the property with all operations and expenses being borne by the oil company. The taxpayer claimed the right to take depletion on the entire production instead of on one-third. The Government did not even contest the right to take depletion on the one-third but denied the depletion on the two-thirds because the oil company was the one entitled to depletion on that part, and the court sustained the position of the Government. It will be noted in that case that the taxpayer was allowed the depletion on the one-third interest owned by taxpayer.

In this case respondent owned the minerals in fee and at all times came more clearly within the economic interest test laid down by this Court than many taxpayers who have been allowed by this Court to take

¹²*Spalding v. U. S.*, 97 F. 2d 697.

depletion. Respondent was willing to make a lease but wanted to recover its capital investment in the property through a participation in the returns from the production of the depletable minerals. This took the form of a cash payment, a retained royalty and a participation in the net profits. The provision concerning net profits was merely a method of determining the part of the minerals or their proceeds that should be paid to the respondent as the owner of the minerals in fee. In the preambles to the supplementary agreement, after a reference to the lease, it is recited:

"The parties to said lease have agreed that Second Party shall be entitled to receive twenty per cent (20%) of the net money profits derived by First Party from operations under said lease, said twenty per cent (20%) net money profits interest being specifically described and defined and payable as is hereinafter provided." (R. 42.)

Paragraph I of the contract then provided:

"Second Party, subject to the terms and provisions hereof and in the manner herein provided, shall be entitled to receive twenty per cent (20%) of the net money profits realized by First Party from its operations under and by virtue of the lease referred to above. The net money profits in which Second Party shall participate under the terms hereof, shall be calculated and determined and be payable as hereinafter provided." (R. 43.)

The contract then contained detailed provisions as to the determination of the net profits.

This contract and the lease merely provided for the total return by way of income from the production of petitioner's minerals that petitioner was to receive. It received this total amount because of its fee ownership of the minerals. Certainly, no one can have a greater economic interest in minerals than the fee owner thereof, and it is respectfully submitted that petitioner under every test laid down by the courts is entitled to the $27\frac{1}{2}\%$ depletion upon the amounts received by it under the 20% net profits agreement.

We refer briefly to the statement of the court below that, if depletion were allowed on the net profits, the depletion could not be ascertained until the amount of net income is determined and that "This poses an abstruse problem instead of the rule of thumb that the arbitrary percentage-depletion allowance was intended to be." We see no abstruse problem involved. The statute says that petitioner will be allowed a depletion of $27\frac{1}{2}\%$ of its gross income. We see no difficulty in computing the $27\frac{1}{2}\%$ allowance upon the income that was received by petitioner from the 20% provision. The amount received in the year involved was \$26,223.70, and $27\frac{1}{2}\%$ of that was \$7,211.52. (R. 33.) Judge Hutcheson in his dissenting opinion found no difficulty in determining petitioner's allowance on this basis, saying "the 20 per cent payment it received constituted, under *Helvering v. Producers*, 303 U. S. 382, the 'gross income' on which its

depletion must be taken." "We see no abstruse problems or involved administrative difficulties that might arise.

Conclusion.

It is respectfully submitted that this case is such as to call for the exercise by this Court of its supervisory powers, and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit be granted.

HOMER L. BRUCE,
Attorney for Petitioner.